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No. 771

AMENDING THE BANKRUPTCY ACT

SEPTEMBER 17 (legislative day, SEPTEMBER 13), 1951.—Ordered to be printed

Mr. McCARRAN, from the Committee on the Judiciary, submitted the following

REPORT

[To accompany H. R. 4693]

The Committee on the Judiciary, to which was referred the bill (H. R. 4693) to amend section 77, subsection (c) (3), of the Bankruptcy Act, as amended, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

PURPOSE

The purpose of the proposed legislation is to amend section 77 (c) (3) of the Bankruptcy Act so as to clarify the power of a bankruptcy court in railroad reorganization proceedings to permit the financing of safety equipment by a railroad by directing that certificates issued for such purpose may be given priority over existing obligations, receivership charges, and past or future state or local taxes, and also shall be entitled to such parity with costs of administration and operation as the judge of the bankruptcy court finds equitable.

STATEMENT

Section 77 (c) (3) of the Bankruptcy Act permits a judge, upon 15 days' notice after such publication as the judge in his discretion deems necessary and with the approval of the Interstate Commerce Commission, to authorize the trustee of a railroad undergoing reorganization to issue certificates for cash, property, or other consideration approved by the judge, under such terms and conditions and with such security and priority over other debts as might in an equity receivership be lawful.

A question concerning the scope of the power conferred by this provision has arisen as a result of the reorganization of the Long Island Rail Road. The trustee of the Long Island Rail Road Co., after con-

sultation with representatives of the Long Island Rail Road Commission, the Public Service Commission of the State of New York and the Interstate Commerce Commission, sought and secured court sanction for the installation of automatic train control devices on the Long Island Rail Road at an estimated cost of \$6,000,000. However, because of the insecure financial condition of the Long Island Rail Road, the trustee encountered difficulty in obtaining a loan to finance the purchase and installation of the control equipment. Finally, however, he was able to secure an offer to make the loan from a group of banks in New York subject to the opinion of legal counsel that the certificates to be issued could validly be given priority over past and future tax obligations, as proposed by the court order, under the terms of section 77 (c) (3). The counsel selected by the bank indicated that they were not entirely satisfied concerning the validity of the subordination of tax claims in this situation under the present law.

Several persons, including legal counsel available to the trustee, believe that the present law already contains the authority necessary to grant the priority sought. The Department of Justice in reporting on this bill seems to affirm that contention. However, the Department concedes that since no court has passed directly on the matter, the scope of the court's power to grant the priority under the present subparagraph is uncertain. Even if the court does have the power, however, the practical consideration remains. If this legislation is not passed, the safety program on a railroad which suffered two disastrous wrecks in 1950 will be jeopardized.

The committee believes that this legislation should be favorably considered. The discretion specifically granted to the judge of a bankruptcy court by the amendment proposed in this bill is proper. It should be kept in mind that a primary motivation in railroad reorganizations is the desire to keep the railroads operating. A railroad in or out of reorganization cannot operate successfully unless it operates safely. Granting discretion to the judge of a bankruptcy court to give the purchase and installation of safety equipment priority over some obligations and parity with others represents a valuable aid to the safe operation of railroads undergoing reorganization.

Attached to this report are the reports of the Department of Justice and the Legislative Committee of the Interstate Commerce Commission submitted in connection with a similar bill.

INTERSTATE COMMERCE COMMISSION,
Washington, D. C., May 28, 1951.

HON. EMANUEL CELLER,
Chairman, Committee on the Judiciary,
House of Representatives, Washington, D. C.

MY DEAR CHAIRMAN CELLER: Your letter of April 26, 1951, addressed to the Chairman of the Commission and requesting an expression of views on H. R. 3751, introduced by Congressman Leonard W. Hall, to amend section 77, subsection (c) (3), of the Bankruptcy Act, as amended, has been referred to our Legislative Committee. After careful consideration by that Committee, I am authorized to submit the following comments in its behalf:

Subsection (c) (3) now empowers judges in proceedings under section 77 to authorize trustees "to issue certificates for cash, property, or other consideration approved by the judge, for such lawful purposes and upon such terms and conditions and with such security and such priority in payments over existing obligations, secured or unsecured, or receivership charges, as might in an equity receiver-

ship be lawful." We understand that the trustee of the Long Island Rail Road desires to issue such certificates in the amount of \$6,000,000 to finance the acquisition of safety equipment designed to prevent accidents such as those which occurred on this railroad some time ago, and that securing such a loan will be facilitated if the certificates therefor can be given priority over tax liens and taxes levied on the railroad property in the future.

Accordingly it is proposed in H. R. 3751 to add a sentence to subsection (c) (3) which would permit such priority "where such certificates are authorized to provide funds to pay for the acquisition, assembly, or installation of safety equipment or materials related thereto, or for the purpose of reimbursing the trustee or trustees for funds so expended." In our opinion this objective is desirable. However, the sentence proposed to be added provides for priority not only over taxes but also over "all or any portion of the costs or expenses of administration or operation." This apparently would make the obligation of the certificates superior to payments for wages, supplies, and other expenses necessary to the operation of the railroad, and such a broad priority seems clearly objectionable. We therefore recommend that the bill be amended by deleting from lines 16 and 17 of page 2 the words "and all or any portion of the costs or expenses of administration or operation" and from line 22 on the same page the words "costs or expenses."

In lines 10 and 11 of page 1 of the bill there is a reference to section 20 (a) of the Interstate Commerce Act. This repeats an inadvertent error of draftsmanship which occurred at the time of original enactment of subsection (c) (3). The reference should have been to section 20a. We therefore recommend that "20 (a)" in line 11 be changed to "20a." We point out also that in line 6 of page 2 there is no comma between the words "charges" and "as", contrary to the punctuation of the present subsection (c) (3).

If the amendments above suggested are made, we recommend that H. R. 3751 pass.

Respectfully submitted,

WALTER M. W. SPLAWN,
Chairman, Legislative Committee.
CHARLES D. MAHAFFIE.
JOHN L. ROGERS.

DEPARTMENT OF JUSTICE,
OFFICE OF THE DEPUTY GENERAL,
Washington, June 19, 1951.

HON. EMANUEL CELLER,
Chairman, Committee on the Judiciary,
House of Representatives, Washington, D. C.

MY DEAR MR. CHAIRMAN: This is in response to your request for the views of the Department of Justice concerning the bill (H. R. 3751), to amend section 77, subsection (c) (3), of the Bankruptcy Act, as amended.

Section 77, subsection (c) (3) of the Bankruptcy Act, as amended (11 U. S. C. 205 (c) (3)), now provides that the judge, for cause shown, upon the giving of the required notice, and with the approval of the Interstate Commerce Commission, may authorize the trustee in bankruptcy to issue certificates for cash, property, or other consideration approved by the judge, for such lawful purposes and upon such terms and conditions and with such security and such priority in payments over existing obligations, secured or unsecured, or receivership charges as might in an equity receivership be lawful.

The first part of section 1 of the bill substantially follows the wording of the present subsection (c) (3), but new provisions are added authorizing the judge to direct that any certificates issued to provide funds for the acquisition, assembly, or installation of safety equipment or related materials, or for the purpose of reimbursing the trustee for funds so expended shall have such lien on the property of the debtor and be entitled to such priority in payment over existing obligations, secured or unsecured, receivership charges, costs or expenses of administration or operation, including debts or taxes payable to any State or to any subdivision or instrumentality thereof as the judge may find equitable regardless of whether such obligations are secured by liens on real and personal property or whether they become payable before or after the issuance of such certificates.

The scope of the court's power to provide for priorities under the present subsection (c) (3) is limited by the phrase, "with * * * such priority in

payments over existing obligations, secured or unsecured, or receivership charges as might in an equity receivership be lawful." Under this provision express authority to grant priority to the certificates is given only with reference to existing obligations and receivership charges. The proposed new portion, which authorizes the granting of priority for certificates that may be issued to pay for safety equipment, extends the priority for such certificates over any or all of the expenses of administration or operation, including duties, debts, or taxes payable to a State, its subdivisions or instrumentalities.

There is some question as to the need for this proposed extension of the court's power to authorize a priority in this narrow field. This is because the purchasing of necessary safety equipment is an expense of operation that must be met if a railroad is to be kept in operation—and railroads must be kept in operation. The courts therefore recognize that in railroad receivership cases operating expenses by implication have the highest priority. In *Reconstruction Finance Corporation v. M. K. Tex. R. Co.* (122 F. (2d) 325 (C. C. A. 8)), the court held that certificates of indebtedness issued by a trustee to the RFC in a railroad-receivership case under a court order making them prior to outstanding mortgages, bonds, and interest and all other obligations of every nature, were nevertheless inferior to the operating expenses. The court said (p. 331):

"The conclusion ought not be indulged unless inexorably compelled by the language of the order and the conditions under which it was made, that the court was intending to fetter and perhaps render wholly impossible, the continued operation of the railroad by an impotence to make acceptable provisions for necessary future expenses."

The courts probably would take an analogous position in construing the limitation imposed by the present subsection (c) (3) and hold that in spite of the express limitation of priorities to those over existing obligations and receivership charges, certificates given to pay for safety equipment could by implication be given priority over such items as duties, debts, or taxes payable to a State and perhaps over other operating expenses. However, since no court has passed upon the matter, the scope of a court's power to grant priority under the present subsection (c) (3) is uncertain.

The power of the court to grant security and priority to the trustees' certificates is in the present subsection (c) (3) limited by the phrase "as might in an equity receivership be lawful." The corresponding limitation in the proposed new provision of the bill reads, "as in the particular case the judge may find equitable at the time of authorizing the issuance of such certificates." It is believed that priority of the character provided for in the proposed new provision could be granted under either limitation.

The effect of the bill would be to make certain that in a reorganization proceeding under section 77 of the Bankruptcy Act the judge would have the power to direct that, where certificates are authorized for the special purpose of providing funds for the installation of safety equipment or related materials or for reimbursing the trustee for funds so expended, such certificates shall have priority, not only over existing obligations and receivership charges (as provided in the present subsection (c) (3)), but over all or any portion of the costs or expenses of administration or operation, including duties, debts, or taxes in favor of a State or its subdivisions or instrumentalities.

Section 2 of the bill specifies when the legislation shall take effect and makes it applicable to any authorization of certificates given by the judge before the date of approval of the measure. Section 2 further provides that neither the enactment of the measure nor anything contained therein shall imply that a judge is not now vested with the power the act expressly grants to him.

The words "or during proceedings under this section or before," in line 1 of page 3 of the bill would appear to be surplusage and it is suggested that they be deleted.

Whether the bill should be enacted involves a question of policy concerning which this Department prefers not to make any recommendation.

The Director of the Bureau of the Budget has advised that there is no objection to the submission of this report.

Yours sincerely,

PEYTON FORD,
Deputy Attorney General.

CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

SECTION 77, SUBSECTION (C) (3) OF THE BANKRUPTCY ACT (49 STAT. 911)

"(3) The judge may, upon not less than fifteen days' notice published in such manner and in such newspapers as the judge may in his discretion determine, which notice so determined shall be sufficient, for cause shown, and with the approval of the Commission, in accordance with section [20 (a)] *20a* of the Interstate Commerce Act, as now or hereafter amended, authorize the trustee or trustees to issue certificates for cash, property, or other consideration approved by the judge, for such lawful purposes and upon such terms and conditions and with such security and such priority in payments over existing obligations, secured or unsecured, or receivership charges, as might in an equity receivership be lawful. *Where such certificates are authorized to provide funds to pay for the acquisition, assembly or installation of safety equipment or materials related thereto, or for the purpose of reimbursing the trustee or trustees for funds so expended, the judge may direct (without limitation of his power to make such direction in the absence of this provision) that the certificates shall have such lien on the property of the debtor and shall be entitled to such priority in payments over existing obligations, secured or unsecured, and receivership charges and present or future duties, debts, or taxes or other obligations in favor of or payable to any State or any subdivision, agency or instrumentality thereof and interest or penalties, and to such parity with all or any portion of the other costs or expenses of administration or operation as in the particular case the judge may find equitable at the time of authorizing the issuance of such certificates, regardless of whether such obligations, charges, costs or expenses, duties, debts, or taxes constitute or are secured by liens on real or personal property or shall have become payable before or after the issuance of such certificates.*"

SEC. 2. This Act shall take effect immediately upon the date of its approval and shall apply to any authorization given by the judge, regardless of whether such authorization shall have been given before or shall be given after such date. Neither the enactment of this Act nor anything herein contained shall be construed as implying that, prior to the date of approval of this Act, the judge was not vested with the power which is expressly granted to him by this Act.

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